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Summary of the Economic and Social Survey of Asia and the Pacific 2015

Note by the Secretary-General

The Secretary-General has the honour to transmit herewith a summary of the *Economic and Social Survey of Asia and the Pacific 2015*.

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Summary of the Economic and Social Survey of Asia and the Pacific 2015

Summary

The year 2015 marks a watershed in global policymaking. It is the deadline for achieving the Millennium Development Goals, and it is expected that a set of sustainable development goals will be adopted in September to provide a framework for development policies beyond 2015. In view of these aspects, now is an opportune time to evaluate how successful the Asia-Pacific region has been in making economic growth more inclusive and sustainable. Therefore, the *Economic and Social Survey of Asia and the Pacific 2015* contains an examination of the economic growth performance in the region, highlighting the challenges that it is facing and with analyses of whether growth has benefited all people.

Economic growth in the developing economies of the region is expected to increase slightly in 2015. This outlook is primarily associated more with domestic and intraregional factors than with external factors. Despite the slight improvement in the economic outlook for the region, economic growth is not as high as it could be or has been in the past. The growth potential of the region's developing economies is being held back by structural weaknesses, such as infrastructure shortages and the excessive commodity-depoendence of some economies. The fragile global economic recovery is just an additional constraint that is not helping growth prospects. More importantly, there is concern that not all have shared equally in the benefits of economic growth; that is, it has not been sufficiently inclusive. Inequality of income as well as of opportunity has risen between different geographies and sections of society, such as in rural and urban areas and among women and men.

In view of these challenges, a number of policy considerations emerge. One such consideration is the need to establish an enabling policy and institutional environment to support the flow of innovative and equitable finance for implementation of an ambitious sustainable development agenda. A second consideration is the need for well-thought-out macroprudential measures to manage capital volatility, thus supporting economic stability and providing a resilient platform for inclusive growth. The imperative for commodity-dependent economies to diversify their economies into other sectors is the third area that is investigated. Fourth, some innovative actions that could be taken by economies in the region to better address climate change, particularly topical in the run-up to the United Nations Conference on Climate Change in Paris, are also discussed.

The thematic chapter of the *Survey* for 2015 examines how inclusive growth has been in the Asia-Pacific region. In doing so, it recognizes that inclusiveness is a multidimensional concept that spans economic, social and environmental dimensions of development. The analysis finds that growth has been more inclusive at the country level. Yet, large divergences of inclusiveness exist within countries between sexes and across the rural and urban sectors. It is of particular concern that income inequalities are large and widening in many countries, with wealthier people being able to secure access to better education and better health services, thereby increasing their employment prospects. If these inequalities are not addressed, intergenerational inequities have the potential to be perpetuated.

Making economic growth more inclusive requires strengthening the developmental role of the state. While Governments should create an enabling environment for the private sector to act as the main engine of growth, more efforts are needed to ensure equality of opportunities. There is a need for countries to make expenditure more development-oriented, particularly to ensure more equal access to education and health care and provide stronger social safety nets. Moreover, access to financial services needs to be broadened, particularly in rural sectors. Greater attention must be given to fostering the creation of employment, particularly by developing small and medium-sized enterprises and fostering rural industrialization.

I. Introduction

1. The year 2015 marks a watershed in global policymaking. It is the deadline for achieving the Millennium Development Goals, and it is expected that a set of sustainable development goals will be adopted in September to provide a framework for development policies beyond 2015. In view of these aspects, now is an opportune time to evaluate how successful the Asia-Pacific region has been in making economic growth more inclusive and sustainable. Therefore, the *Economic and Social Survey of Asia and the Pacific 2015* contains an examination of the economic growth performance in the region, highlighting the challenges that it is facing and with analyses of whether growth has benefited all people.

2. Real incomes per capita in developing economies of the region have doubled on average since the early 1990s. In countries such as Bhutan, Cambodia and Viet Nam, real income per capita has tripled, while in China it has grown more than sevenfold since 1990. Such impressive performances have lifted millions of people out of extreme poverty and has enabled the region as a whole to meet — ahead of the 2015 deadline — the first target under the Millennium Development Goals, namely, that of reducing by half the proportion of people whose income is less than $1.25 a day.

3. However, despite the region's success in achieving economic growth at high rates and significantly reducing poverty, economic growth is not as high as it could be or has been in the past. The region is expected to experience only a slight increase in its economic growth rate in 2015 and 2016. Reflecting this trend in economic growth and supported by lower international oil prices, inflation is forecast to decline further and remain low. More importantly, there is concern that not all have shared equally in the benefits of economic growth; that is, it has not been sufficiently inclusive. Inequality of income as well as of opportunity has risen between different geographies and sections of society, such as in rural and urban areas and among women and men.

4. Thus, a fundamental issue explored in the *Survey* for 2015 is that, while policy focus on economic growth is necessary, it is definitely not sufficient for achieving "development". Policymakers in the region will have to internalize the aspects of inclusive growth and sustainable development into their domestic policy frameworks in order to surmount the emerging challenges. It is a year in which countries ought to be gearing themselves up to adopt and adapt the proposed sustainable development goals.

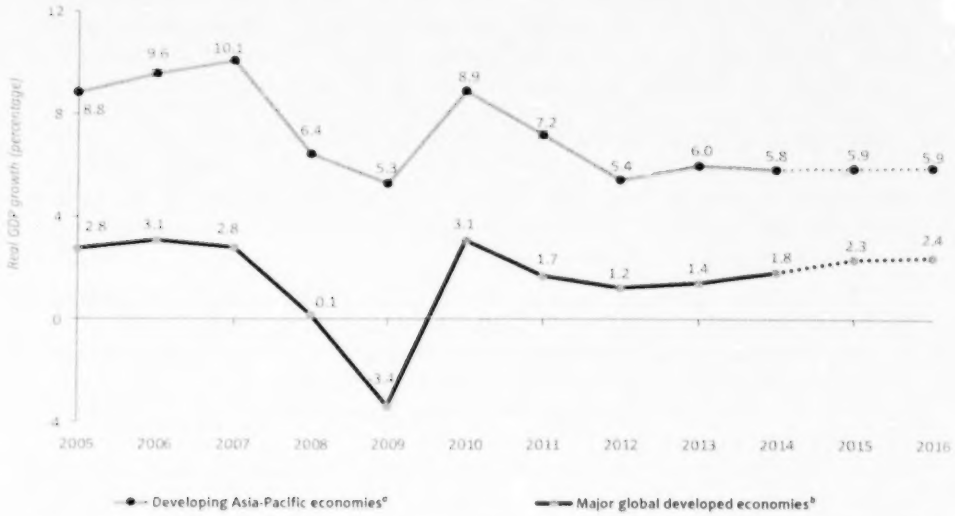
5. In the second section of the present summary of the *Survey*, there is an examination of the macroeconomic outlook and performance in the Asia-Pacific region. The section also contains analyses of some of the economic challenges faced in the region, as well as a discussion of some key policy options. To reflect the diversity of the Asia-Pacific region, the third section provides a more disaggregated analysis of economic issues and challenges being faced by each of the five subregions, thereby providing an opportunity to learn from a variety of experiences and policy considerations. Finally, the fourth section affords analyses in greater detail on the issue of just how inclusive growth has been in the region in recent decades.

II. Economic growth outlook and policy challenges

6. Economic growth in developing economies in the region is expected to increase slightly to 5.9 pc cent in 2015 from 5.8 per cent in 2014. This outlook is primarily associated more with domestic and intraregional factors than with external factors. Specifically, the role of private consumption and investment is expected to be much more pronounced in driving economic growth than exports, the prospects for which remain less upbeat. In the assessment of the Economic and Social Commission for Asia and the Pacific (ESCAP), the growth potential of the region's developing economies is being held back by structural weaknesses, such as infrastructure shortages and the excessive commodity-dependence of some economies. The fragile global economic recovery is just an additional constraint that is not helping growth prospects.

7. This outlook is based on expected positive trends in major developing economies, including Bangladesh, India, Indonesia, Papua New Guinea, the Republic of Korea and Thailand. Some of these economies are undertaking reform programmes under new administrations, which are expected to generate positive results in 2015. Despite only a moderate increase in economic growth in developing economies, excluding those in North and Central Asia, the region will continue to lead the global economic recovery, with growth in 2015 expected to be nearly two and one-half times greater than in the major global developed economies (see fig. I). Nevertheless, it is also the case that the growth differential between the region and the developed world is becoming smaller compared with the pre-crisis period, when growth in the region was more than three times faster. The narrowing differential is due to a slowdown in the region and to the fact that the developed economies have returned to growth that is close to their pre-crisis levels.

Figure I
Growth in developing Asia-Pacific economies and major global developed economies, 2005-2015



Sources: ESCAP, based on national sources and CEIC data. Available from www.ceicdata.com (accessed 30 March 2015); forecasts for major developed economies are based on the World Economic Outlook Database of the International Monetary Fund (IMF).

[a] Developing Asia-Pacific economies comprise 37 economies, excluding North and Central Asia. The series reflects the revised estimates of gross domestic product (GDP) growth for India from 2012 onwards. The revised estimates entail shifting of the base year from 2004-2005 to 2011-2012 and also deploying improved methodologies. Caution should be exercised in comparing growth rates between the earlier series and the revised series.

[b] Major developed economies comprise 36 economies, including Japan, the United States of America and the 19 countries belonging to the eurozone.

8. The outlook for inflation is better than that for economic growth. Inflation in the region is expected to decline noticeably to 3.4 per cent in 2015 from 3.9 per cent in 2014. This trend is driven primarily by lower international oil prices and reduced demand pressure in export-led economies. In addition to affecting inflation positively, the dramatic decline in international oil prices has allowed for significant reform in the area of fuel subsidies. This has released extrabudgetary resources, which can be effectively deployed to support infrastructure investment and inclusive growth measures. However, Governments are advised to remain focused on tax policy reforms to strengthen their public finances. This would be important for ensuring macroeconomic stability and for generating adequate resources for development spending.

9. Lower inflation has encouraged a string of interest rate reductions in many regional economies, which may support overall economic growth. However, one policy consideration is that considerable volatility in capital flows and exchange rates in the region can be expected, given the monetary-policy-related developments of major economies, such as Japan, eurozone countries and the United States of America. Such volatility may induce significant macroeconomic and financial instability in the region, risking not only the economic growth prospects for the

region, but also the sustainable development agenda by diverting the attention of policymakers to stability issues only. Therefore, the monetary-policy stance will need to be calibrated much more cautiously in going forward, especially in those economies that have weak fundamentals.

10. Merchandise trade in Asia-Pacific continues to face significant challenges as the year-on-year export and import growth across developing economies has remained weak throughout 2014. Risks to the prospects of trade in Asia and the Pacific in 2015 are mainly due to the slowdown of economic activity in China and the eurozone countries. Given the fact that these economies are major export destinations for most economies of Asia and the Pacific, with shares of 16 and 14 per cent of total exports, respectively, sluggish (import) demand in these economies remains a major risk to the export prospects of the region.

11. The poor trade performance in 2013-2014 occurred despite the apparent progress in the multilateral trade negotiations at the World Trade Organization level after the Bali Ministerial Conference of December 2013. Continued talks regarding two interregional trade deals involving Asia-Pacific economies, namely the proposed trans-Pacific partnership and the regional comprehensive economic partnership, did not help much to reinvigorate trade and investment flows. The proliferation of preferential trade agreements involving Asia-Pacific economies, which began in earnest in the early 1990s, is again under way after a temporary pause in 2012. There are several reasons behind the ongoing rise in preferential liberalization agreements; these include uncertainty about the conclusion of the Doha Round negotiations, continued weak import demand in developed-country markets, and the growing recognition of the benefits of South-South trade and economic cooperation.

12. The Asia and Pacific region has remained a favourable foreign direct investment (FDI) destination over the past few years. In fact, the share of the Asia-Pacific region in global FDI flows has been on the increase since 2005. Therefore, the Asia-Pacific region has demonstrated its resilience in the face of challenges in the global economic climate characterized by relatively low and volatile global FDI flows since 2007. Within Asia and the Pacific region, FDI inflows have varied greatly among different subregions and countries as a result of: (a) different FDI policies adopted by countries; (b) the impact of regional economic blocks; (c) macroeconomic uncertainties and structural constraints; and (d) geopolitical tensions.

13. In terms of structural reforms, some Governments are taking measures to strengthen their public finances, especially in the area of tax reform. Some countries are also moving to address land acquisition procedures, which have been one of the key barriers to private sector investment in many cases. Some Governments have also been engaged in the process of reducing the role of state-owned enterprises, as well as increasing foreign business participation. By doing so, they are attempting to reduce the fiscal burden of such enterprises, as well as increase their efficiency, and thereby increase their contribution to growth and employment.

14. To increase the supply potential of developing economies in the region, in which demand continues to remain substantial, owing to growing populations and incomes, the availability and quality of infrastructure will have to be improved. Furthermore, the region's significant role in global trade and global production networks means that improved infrastructure will also enable economies to better

service global demand. Improving infrastructure will also allow economic growth to be more inclusive by allowing the fruits of development to reach more persons, especially those in rural areas and the poorer sections of the society in urban areas.

15. In any case, increasing urbanization throughout the region is creating additional demands for infrastructure. Urbanization is expected to grow in line with rising wealth in the region, as higher-income economies typically have higher levels of urbanization. Some of the effects will be increased demand for utilities and for housing. There will also be a greater need for public transportation, in order to reduce the burden of congestion resulting from private vehicles. In meeting the diverse but related challenges posed by urbanization, it is logical for infrastructure deficits to be tackled in an integrated way that supports both sustainable and inclusive urban growth, but also ensures that the economic potential of the region's cities is realized.

16. While traditional sources of finance, such as tax receipts and overseas development assistance, may be important, they are inadequate to meet the infrastructure development requirements of the region. It will also be necessary to effectively develop regional capital markets and encourage public-private partnerships to bridge the wide financing gap. A supportive legal and regulatory environment, together with enhanced capacity to evaluate infrastructure projects, can go a long way in achieving this objective. The emergence of new development banks, for instance, the Asian Infrastructure Investment Bank, is also a welcome sign for infrastructure development in the region.

17. In terms of external challenges, expectations about monetary policy normalization by the United States of America have already led to a substantial increase in the dollar vis-à-vis currencies globally. Exchange rates in the region have also been affected by the strength of the dollar but there has been considerable divergence in performance between economies. A number of factors explain the relatively small depreciation in some currencies in the region. One is foreign exchange intervention by Governments, owing to concerns about imported inflation stemming from depreciation and to increased foreign debt repayment costs. Another reason for the relatively small decline in the value of currencies in some economies of the region is continuing institutional investor interest in financial assets, due to better growth prospects in comparative global terms.

18. Apart from the impact on exchange rates, capital outflows have the potential to undermine macroeconomic stability and household wealth by their impact on domestic asset markets. Some of the key asset markets in relatively open economies that had seen significant foreign capital inflows are the equity, bond and property markets. Outflows from these markets can destabilize the banking sector, as domestic banks may suffer losses on their investments in these markets, while they also negatively impact household wealth and therefore consumption because households will see declining values for their investments in these markets. Some economies have attempted to manage the scale of capital outflows from such markets by imposing or increasing macroprudential regulations in these areas.

19. Macroprudential policies offer an important complementary method of managing capital flows. They directly target the source of instability of capital flow volatility, namely, the domestic asset markets in which capital flows are invested. Such regulatory policies are aimed at reducing systemic risks, safeguarding the stability of the financial system as a whole against domestic and external shocks,

and ensuring that it continues to function effectively.[1] Rather than changing the cost of borrowing for the entire economy, macroprudential policies are targeted at controlling credit to what central bankers see as specific areas of financial excess.

20. Macroprudential policies can be grouped as follows: (a) caps on loan-to-value ratios, such as those in the housing sector; (b) limits on credit growth and other balance sheet restrictions, such as debt service limits on credit cards and personal loans; (c) explicit ceilings on banks' credit growth; and (d) capital and reserve requirements and surcharges, such as countercyclical capital requirements and higher reserve ratio requirements.[2] Typically, macroprudential policies differ from capital flow measures, which are meant to limit capital flows by non-residents. However, on occasion macroprudential policies may also include capital flow measures, such as in the case of policies to discourage foreign-currency borrowing. Macroprudential policies are normally enacted by central banks and are complementary to fiscal measures undertaken by Governments, such as increasing taxes and stamp duties on investors in certain sectors.

21. Commodity price swings are nothing new, but the recent sharp drop in the price of Brent crude oil has caught many economic managers in the region by surprise. Coal prices have also declined in recent quarters, affecting major exporters, such as Australia and Indonesia. Natural gas prices are also likely to fall, as they tend to track oil prices with some lag. Industrial metals, such as copper, iron ore and nickel, have also witnessed downward volatility, as is the case with food and agricultural raw materials, such as palm oil and rubber. While various demand and supply factors are at play, the recent decline in commodity prices may signal the end of a "commodity super cycle" after more than a decade of a commodity boom, which was only briefly interrupted by the global financial crisis.

22. Commodity-dependent economies, with different income levels and population sizes, are expected to feel negative impacts on multiple fronts, including output and employment, external and fiscal balance, and price and financial stability, largely via the exchange rate channel. In the longer term, commodity-dependence can affect the process of structural change in economies. Resource-rich economies tend to undergo less economic diversification, even as aggregate output and income rises.

23. Importantly, lack of diversification among commodity exporters is sometimes associated with weak governance and business environments. This is possible because of excessive rent-seeking activities. Human capital also tends to suffer, as primary sectors, such as mining, cannot absorb much labour compared with manufacturing. These deficits could hamper economic development, particularly the private sector. But it is also a concern because resources-driven economies would require a large public sector in order to distribute the wealth equitably across the population. But if there is much corruption and weak capacity in the Government, welfare gains will neither be widely nor efficiently realized.

24. There are several policy options that can be considered in tackling the challenges offered by the commodity-dependence of economies. For instance, instead of adopting fiscal rules for the overall budget deficit that are independent of

[1] Bank for International Settlements, "Group of Central Bank Governors and Heads of Supervision reinforces Basel Committee reform package", press release, 11 January 2010.

[2] Stijn Claessens, "An overview of macroprudential policy tools", IMF Working Paper WP/14/214 (IMF, 2014). Available at www.imf.org/external/pubs/ft/wp/2014/wp14214.pdf.

the business cycle, it is possible to target a structural or "cyclically adjusted balance", which can take into account the potential revenue shocks that are due to large movements in commodity prices.

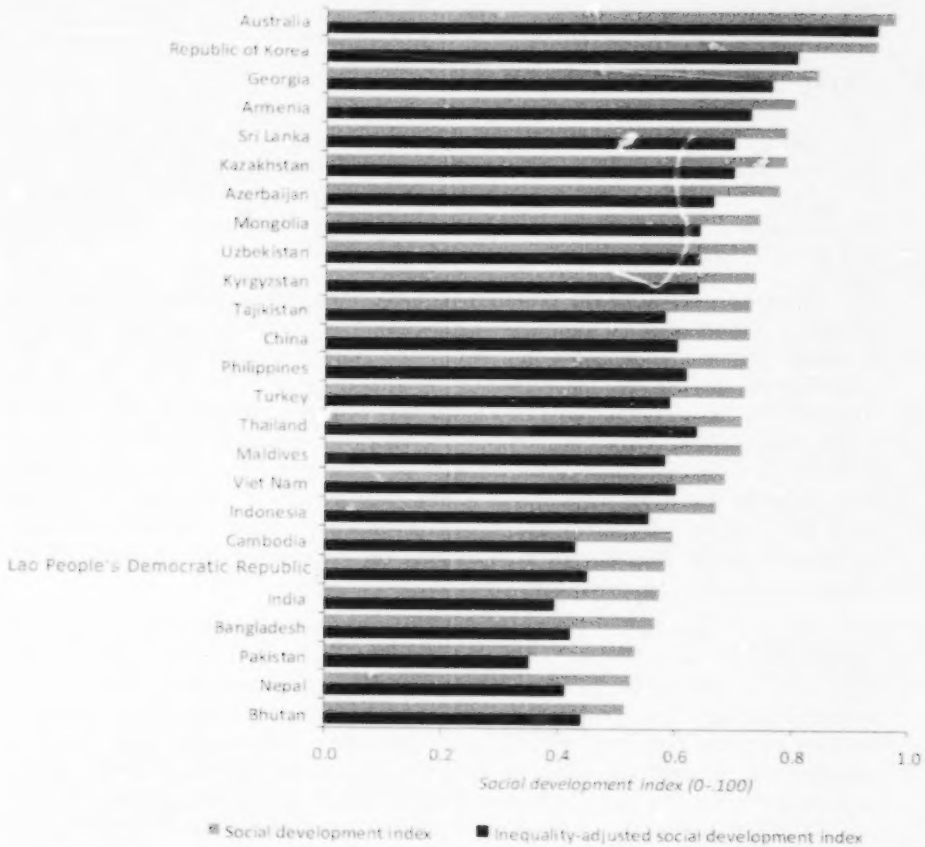
25. Similarly, an inflation target based on the consumer price index may not be appropriate for countries susceptible to bouts of trade shocks. Indices have been suggested that are more production oriented, rather than consumption oriented, so as to automatically accommodate fluctuations in the export price, while furnishing a nominal anchor for inflation expectations. The producer price index, for instance, could be modified to weight sectors not according to gross sales, but rather value added, as in the national income accounts.

26. Effective use of industrial and foreign direct investment policies for diversification from commodities is also possible. As part of industrial policy, the Government, the private sector and civil society could, in a participatory manner, come up with the required supportive policies, incentive structure and institutional arrangement to ensure flows of investment into the strategic sectors. For instance, they could target the promotion of new products and services that are higher value added and that allow for further diversification of the economy. Another way to facilitate strategic diversification is through attracting foreign investment while ensuring meaningful linkages and spillovers into the local economy and local enterprises.

27. Countries will also have to deal with significant challenges that are holding back the achievement of the inclusive aspects of growth, a subject which is explored in detail in section III. Income inequality (Gini index) has recently emerged as a significant concern for policymakers across the globe. One reason among many for this concern is the cost it imposes on achieving inclusive growth and development. ESCAP analysis indicates that high levels of inequality are undermining the economic and social achievements of the region. To estimate the negative impact, the analysis discounted levels of per capita income for 32 countries in the region with available data by a factor proportional to the extent of income inequality. The findings are that the GDP per capita declines substantially for many countries with relatively high Gini index levels (see fig. II). Furthermore, a social development index, when discounted for inequality, is also found to decline by up to 25 per cent for some countries.

28. Inequality of opportunity is also manifest in many components of social development where multiple forms of deprivation overlap and reinforce each other. A fundamental obstacle to inclusive growth is patriarchy. Inclusive growth cannot be achieved without addressing the discrimination, oppression and subjugation of women and girls, in both the public and private domains. In this respect, the exclusion of women from the economic realm and political governance needs to be addressed. Achieving inclusive growth must also be underpinned by provision of sufficient decent jobs. However, the region is still struggling to create adequate jobs in the formal sector and to improve overall job quality. In order to achieve inclusive growth, improving employment prospects for young people will be essential, as will addressing widespread vulnerable employment.

Figure II
Inequality-adjusted GDP per capita, 2012-2013



Sources: Based on data from the United Nations Development Programme (UNDP), *Human Development Report 2013*; ESCAP, *Statistical Yearbook for Asia and the Pacific 2014*; and the United Nations Statistical Division.

29. The environmental dimension of sustainable development is of particular importance to inclusive growth. The main areas of concern are addressing climate change and issues of sustainable energy. Climate change poses threats to sustainable development, as the adverse impacts of climate change can cut back decades of development gains. To turn the mitigation of the impact of climate change into opportunities, the policy instruments for mitigation should be aimed at generating co-benefits or double dividends, while paying attention to inclusiveness.

30. Energy security is also a pressing concern for regional sustainable development for a number of reasons. First, energy demand in the region has increased significantly. Second, many developing countries in the region are expected to continue to depend on imported fossil fuels and therefore be exposed to price volatility. Thirdly, the excessive energy-intensity of growth has resulted in numerous challenges, such as air pollution, threats to public health and harm to

economic competitiveness. Energy security can be leveraged by expanding energy access, developing renewable energy and improving energy efficiency — the three objectives of the United Nations Sustainable Energy for All initiative. Together with UNDP and the Asian Development Bank, ESCAP has formed a regional hub to implement that initiative.

III. Perspectives from subregions

31. The Asia-Pacific region is home not only to some of the richest and fastest-growing economies in terms of economic growth, but also to numerous poor and struggling economies with serious development challenges. A subregional perspective therefore provides an opportunity to learn from a variety of experiences and policy considerations.

32. Despite a revival in the economy of the United States of America, economic growth in export-oriented East and North-East Asia moderated in 2014, owing to subdued domestic demand. In China, the shift towards more sustainable, consumption-led growth has resulted in slower growth in fixed investment. Similarly, in Japan, output growth has stalled, with larger-than-expected quarterly contractions following the consumption tax hike in April 2014. Fiscal stimulus was launched in both China and Japan, as well as in the Republic of Korea, to combat tepid growth. In terms of outlook, economic growth is projected to increase modestly over 2015 and 2016, due to a slight pickup in Japan and stronger growth momentum in the Republic of Korea. With regard to China's economic growth, however, a slightly increased downward trend is expected.

33. An immediate policy challenge for East and North-East Asia is to cope with slowing demand from China. In this regard, efforts are being made to enhance trade connectivity, such as the Chinese-led initiative to set up the Asian Infrastructure Investment Bank. The Governments of countries in the subregion also introduced policies to boost domestic demand as an alternative source of growth, but their success will be constrained by the currently high debt levels and rapidly ageing population. Policies to address the multifaceted nature of an ageing population, such as job sharing and innovative financial products, are critical to overcoming medium-term challenges.

34. In the North and Central Asia subregion, the already sluggish economic growth in the Russian Federation in recent years was exacerbated by lower global oil prices and geopolitical tensions. As a result, the economy barely grew in 2014, while considerable contraction is expected during 2015 and 2016. Since the Russian Federation accounts for 80 per cent of economic output in North and Central Asia, subregional growth performance and prospects are also bleak. Already, subdued foreign exchange earnings resulting from declining commodity prices have led to the weakening of several of the subregion's currencies. Thus, unlike elsewhere in Asia and the Pacific, inflationary pressures are rising in North and Central Asia. This leaves the subregion in a low-growth, high-inflation situation.

35. Sources of economic growth in North and Central Asia are highly concentrated. In Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan, natural resources rent, defined as the difference between a commodity's price and its average production cost, amounts to between 37 and 47 per cent of GDP. In Armenia, Kyrgyzstan and Tajikistan, overseas workers' remittances account for

between 13 and 41 per cent of GDP. Policy reforms to diversify sources of economic growth would involve creating a dynamic, entrepreneurial private sector and strengthening the linkages between resource-based and non-resource-based sectors.

36. Pacific island developing economies grew at a three-year high rate in 2014. The expansion took place in nearly all those economies, but growth was driven mainly by mineral resource production in Papua New Guinea, which accounts for close to 60 per cent of the output of those economies. A devastating cyclone led to an economic contraction in the Solomon Islands in 2014, which highlights the subregion's vulnerability to frequent natural disasters. Catastrophes often disrupt economic growth and macroeconomic stability, given the small populations, limited land area and restricted room for macroeconomic policy response in those island economies. In terms of outlook, economic growth is projected to increase further, benefiting from strong mineral exports in Papua New Guinea, continued post-cyclone reconstruction activity in some countries and expected increases in tourism and remittance receipts.

37. Faster output growth is needed to generate more jobs in Pacific island developing economies where many people remain unemployed or still engage in subsistence activities. Limited infrastructure networks and human and institutional capacity have resulted in the subregion's low and uneven economic growth record. A more vibrant business sector would expand the economic base, reduce youth unemployment and support government revenue that could be spent to reduce notable gaps in service delivery in rural areas and outer islands.

38. Economic growth in South and South-West Asia in 2014 edged up but remained far below the subregion's impressive performance prior to the 2008 global crisis. The uptick was led mainly by stronger macroeconomic performance in India, which accounts for slightly more than half the output in the subregion. Economic growth also strengthened in Bhutan, Nepal, Pakistan and Sri Lanka, and was stable at rather high levels in Bangladesh and Maldives. The outlook for 2015 and 2016 is optimistic. Continued domestic reform efforts would help to unleash high potential growth that the subregion gains from a young population and abundant farm workers who can move to higher value-added manufacturing activity.

39. Three interconnected macroeconomic imbalances, namely, large fiscal deficits, sizeable current account shortfalls and high inflation, have retarded faster economic growth in South and South-West Asia. Tax reforms would help lower public borrowings, which have added inflationary pressure to the economies and contributed to wide saving-investment gaps. In addition to macroeconomic imbalances, severe power shortages are a key growth constraint. A broad-based policy effort is needed to tackle the energy crisis, for example, expanding the fiscal space, setting up an appropriate framework for public-private partnerships and enhancing corporate governance in public enterprises.

40. In South-East Asia, economic growth momentum softened in 2014 amid monetary tightening and weak commodity exports in Indonesia, political unrest in Thailand and cooling of the real estate sector in Singapore. Growth also slowed, albeit from a high base, in subregional economies with lower income levels, such as Cambodia, the Lao People's Democratic Republic and Myanmar. The near-term outlook is projected to improve, mainly underpinned by an economic recovery in Thailand and more rapid growth in Indonesia and the Philippines.

41. An increasing role has been observed in South-East Asia with regard to private consumption in supporting economic growth. While this helps to raise the subregion's resilience vis-à-vis external demand shocks, such consumer spending is financed largely by capital inflows. Regarding medium-term challenges, two key growth constraints are shortages of public infrastructure and skilled labour. With regard to infrastructure, the subregion needs to mobilize part of its available savings to reverse the declining trend in public infrastructure outlays. With regard to workers' skills, secondary enrolment should be actively encouraged and the quality of education and vocational training should match the needs of job markets.

IV. Inclusiveness and growth

42. Understanding the economic growth dynamics and prospects of the Asia-Pacific region, together with recognizing its achievements in terms of higher growth and poverty reduction, remains an important endeavour. However, development and overall human welfare is a multidimensional concept that involves more than just increasing the levels of income and reducing the levels of poverty. As highlighted in the first *Human Development Report*, "the purpose of development is to offer people more options. One of their options is access to income ... but there are other options as well, including long life, knowledge, political freedom, personal security, community participation and guaranteed human rights".[3]

43. Inclusiveness is thus also a multidimensional concept. Yet, while the term "inclusive growth" has been widely used by Governments, international organizations and other stakeholders in recent years, there is still a lack of consensus on a clear understanding of the concept. Keeping in view the broad social objective of human well-being, the inclusiveness definition should encompass the dimensions of economic inclusiveness, social inclusiveness and environmental inclusiveness. This captures the essence that representatives of Member States agreed upon in the outcome document of the United Nations Conference on Sustainable Development, which was held in Rio de Janeiro in June 2012. In that document, entitled "The future we want", they clearly stated their commitment to ensure the promotion of an economically, socially and environmentally sustainable future for the planet.

44. Therefore, the term inclusiveness is understood and defined in the present document as comprising the following: (a) increasing the average standard of living of the population (captured here by average real income per capita); (b) reducing income inequality; (c) reducing levels of extreme poverty; and (d) expanding and broadening equality in opportunities, such as access to public goods, including health and education services. Achievement of these objectives should lead to an increase in people's well-being — the ultimate objective of any society — in an inclusive manner.

Economic inclusiveness

45. Economic growth should be broad-based and inclusive, enabling all segments of the population to benefit from such growth, while incorporating the needs of the

[3] United Nations Development Programme, *Human Development Report 1990: Concept and Measurement of Human Development* (New York, 1990).

extreme poor and vulnerable. The elimination of extreme poverty must be one of the primary social objectives of all Governments, without which inclusive growth cannot be realized. While rates of extreme poverty have declined by half or more in most economies in the region, with the incidence of extreme poverty falling from 51 per cent of the region's population in 1990 to about 18 per cent of the population in 2011, poverty measured at the $2 line is still very high. In India and Nepal, more than 60 per cent of the population was living below this line in 2010. Moreover, there are large divergences in poverty rates within countries, usually across genders, but also between rural and urban areas.

46. Despite the success achieved in reducing extreme poverty, increases in levels of real income have not always been distributed evenly within countries. On the contrary, income inequality has increased in many countries in the region, especially in the major developing countries. Since the 1990s, the population-weighted mean Gini coefficient for the entire region rose from 33.5 to 37.5. In some countries, particularly in the region's larger economies, namely China, India and Indonesia, the Gini coefficient increased considerably. Similarly, in many countries, including the region's more populous economies of Bangladesh, China, India and Indonesia, the richest quintile (20 per cent of the population) has been able to increase its share in national income, while that of the lowest quintile has declined.

47. Overall, while there is no strong evidence in the economic literature that growth affects income inequality, or that income inequality affects growth, it has been generally concluded that high initial inequality is associated with lower later growth. Moreover, high inequality can contribute to greater social, economic and political instability, as when incomes are distributed more unevenly, the ruling classes may expend more effort on protecting their wealth and strengthening rent-seeking activities than on generating inclusive patterns of growth, thereby undermining the quality of governance.

48. One reason for the uneven progress that has taken place within countries is the fact that economic growth has not necessarily resulted in commensurate employment. Indeed, in many developing countries the lack of productive employment is one of the major reasons for a high incidence of poverty.

Social inclusiveness

49. With inequalities emerging in many other components of development, "inequality in income" must be distinguished from "inequality of opportunity", which refers to inequalities resulting from circumstances that are beyond an individual's control. Thus, while outcomes such as "earnings", or "income" can be determined by factors for which a person can be responsible (such as the amount of effort exerted in a job), they are also affected by factors that are beyond a person's control and that are often dependent on family circumstances. Two critical factors in identifying whether growth has been inclusive are the availability of education and health services.

50. Overall, the region has made significant progress in improving access to primary education. However, the picture is different for secondary education and even more so for tertiary education. In many countries, less than half of all children of secondary school age are enrolled in school. Moreover, girls' secondary enrolment often lags behind that of boys, especially in rural areas, although the gap shrinks in higher income quintiles. Indeed, generally, higher income groups receive

more years of schooling than lower income ones. In most countries there are also significant differences in the quality of education received, with the lower income groups mainly attending poorly maintained over-crowded public schools, and the children of the wealthier attending well-funded private schools. Over time, this aggravates intergenerational inequality.

51. Access to health services is a further critical element in identifying whether growth has been inclusive. Better health, for instance, contributes to growth by improving the motivation and productivity of workers. In addition, better health may result in a decline in the dropout rate among schoolchildren and thus reinforce the positive impact of education on growth and equity, especially intergenerational inequality. Access to health services is defined by accessibility, which is largely related to geographic location, affordability, that is, whether people can afford the services that are available, and acceptability, which relates to whether people are willing to use services when they are available and possibly affordable.

52. While most countries in the Asia-Pacific region have made efforts to broaden access to public health care, there are still spatial differences. For example, in a large number of countries in the region, provision is concentrated in urban areas. Moreover, many public health centres do not have qualified and experienced health professionals, with the result that the service provided is often of poor quality. Furthermore, in several countries, most health-care expenditure is borne by private households, which can make health-care services barely affordable to many households, particularly in the lower income quintiles. This is in contrast to countries, including Kiribati and Thailand, that have achieved almost universal health-care services through public service provision or through universal public health insurance. Finally, people may refrain from using health-care services even though they are available and affordable. In some cases this may be due to the perceived lack of good-quality care. In other instances, the services may not be considered socially or culturally appropriate, which is particularly the case when it comes to sexual and reproductive health services.

Inclusive development and the environment

53. There is general agreement that economic growth tends to negatively affect environmental quality. While degradation of the environment has adverse impacts on everyone, the poor are particularly affected, as they are less resilient to the negative impacts of environmental degradation. At the same time, inequality and poverty contribute to environmental degradation, because in less developed countries, and for the poor in general, there is less focus on the complex issues of the environment and how it affects their economic future. Environmental degradation can therefore also be the outcome of economic inequality. Thus, when moving up the development ladder, efforts must be made to safeguard the environment and to increase the access of persons to such basic infrastructures as electricity, clean drinking water and sanitation.

54. The region has made important progress in increasing access to improved water sources since 1990, with the percentage of persons without access to improved water sources dropping from around 27 to about 8 per cent today. Yet, large disparities still exist between rural and urban areas. At the same time, access to improved sanitation has improved more moderately, with only about 59 per cent of the Asia-Pacific population having access to these facilities in 2011, compared

with around 36 per cent in 1990. South and South-West Asia remains the region with the lowest level of access to improved sanitation, with 798 million people lacking access to these facilities. In some countries this may be linked to increasing urbanization pressures, as the number of people living in slums in urban areas has increased significantly.

55. With its economic expansion, the greenhouse gas emissions of the region have increased considerably, owing mainly to the combustion of fossil fuels for electricity generation, transport and industrial uses. Although the carbon dioxide intensity of output has been decreasing, it remains quite high and was approximately 50 per cent higher than the global average intensity in 2010. Responding to increasing demands for energy, electricity production has increased significantly since 1990. However, compared with urban populations, rural populations in many countries still do not have access to basic energy services, with at least 620 million people lacking access to electricity and almost 1.9 billion people relying on biomass for cooking. While renewable sources of energy are becoming increasingly important, fossil fuels remain major energy products in the production process.

Economic and Social Commission for Asia and the Pacific index of inclusiveness

56. The multidimensional character of inclusiveness and the diverging trend of economic, social and environmental indicators clouds any judgement call as to whether growth has been inclusive in the region. For example, while a country may have made significant advances in terms of social development, its success in accelerating poverty reduction or reducing income inequality may be less obvious. Even within each category of the three dimensions of development, it may not be clear whether growth has been inclusive.

57. To address this more methodologically and to reflect the definition of sustainable development that representatives of Member States agreed upon in the outcome document of the United Nations Conference on Sustainable Development, ESCAP has created a composite index of inclusiveness, comprising three sub-indices that measure how inclusive growth has been in economic, social and environmental terms. Each of these sub-indices captures five relevant indicators and computes a score for the periods 1990-1999 and 2000-2012.

58. The table below shows the score and rank of countries for overall inclusiveness for the 16 countries in the region with available data. Among these, economic growth has been the most inclusive in Kazakhstan, the Russian Federation and Thailand and the least inclusive in Bangladesh, India, Nepal and Pakistan. Although economic growth has been more inclusive in recent years in the Asia-Pacific region, some countries have made more progress than others. Thus, a rapid increase in scores of China, the Islamic Republic of Iran and Sri Lanka contributed to the decline in rank of Tajikistan. More inclusive growth in China and the Islamic Republic of Iran also led to a decline in rank of the Philippines.

Table
Scores and ranking of countries for inclusiveness of growth, 1990-1999 and 2000-2012

	Inclusiveness			
	Score		*Rank*	
Countries	*1990-1999*	*2000-2012*	*1990-1999*	*2000-2012*
Bangladesh	0.54	0.60	12	12
Cambodia	0.51	0.56	14	15
China	0.65	0.73	10	7
India	0.53	0.60	13	14
Indonesia	0.58	0.68	11	11
Iran (Islamic Republic of)	0.66	0.73	8	6
Kazakhstan	0.80	0.82	1	1
Malaysia	0.72	0.78	4	4
Nepal	0.48	0.60	15	13
Pakistan	0.46	0.55	16	16
Philippines	0.66	0.70	7	10
Russian Federation	0.77	0.80	2	2
Sri Lanka	0.71	0.77	6	5
Tajikistan	0.72	0.73	5	8
Thailand	0.73	0.79	3	3
Turkey	0.65	0.72	9	9

Source: ESCAP calculations.
Note: The indicators of the index have been normalized linearly and scaled from zero to one, so that a higher score represents an improvement in the indicator/index.

59. Moreover, while economic growth has been inclusive at the country-wide level, large divergences exist within countries between genders, across the rural and urban sector and between regions. Of particular concern is the fact that income inequalities are large and widening in many countries. With the wealthier being able to secure access to better education and better health services, and thereby increasing their employment prospects, intergenerational inequities have the potential to be perpetuated unless inequalities in income are addressed.

60. Several explanations for the widening of income inequalities have been put forward. These include market-oriented reforms that countries have embraced as they integrated more closely with the global economy, as these have affected income distributions within countries. In addition, in many countries, real wage growth has lagged behind productivity growth, thereby contributing to a declining share of labour income in output and a widening of income inequality, owing to the more unequal distribution of capital.

61. While the private sector plays a critical role, making economic growth more inclusive requires strengthening the role of the state in development. The main role of the Government is to ensure that equality of opportunities exists. This includes broadening access to education and health services and strengthening social safety

nets. Governments should also create an enabling environment for the private sector to act as the main engine of growth, comprising strong legal and regulatory frameworks, better coordination and accountability of institutions, and macroeconomic and financial stability through prudent policies.

62. In many countries, greater attention must be given to the development of small and medium-sized enterprises, particularly in the rural sector. Thus, despite the importance of agriculture in terms of providing livelihoods for large proportions of the population, in most developing countries in the region, industry and the services sector were the primary drivers of economic growth, leading to a significant decline in the contribution of agriculture to the region's GDP. Addressing the neglect of agriculture is therefore crucial in reducing poverty and inequality. Options include diversifying into high-value crops, focusing on quality and standards, and investing in research, and development and human capital to increase agricultural productivity.

63. Policies should also emphasize development of the non-farm rural sector by fostering rural industrialization through small-scale industries. This would strengthen linkages between agriculture and non-agriculture sectors, producing both backward-forward and production-consumption linkages within agriculture and between agriculture and non-agriculture sectors. Agricultural productivity growth and consumption linkages generated by increased rural incomes would stimulate the rural economy further. For instance, the income generated by the ready-made garments sector in Bangladesh has created significant spillovers on demand for non-tradable goods and services, which has created a positive impact on poverty dynamics in urban and rural areas and on the development and diversification of small and medium-sized enterprises through backward and forward linkages. Importantly, to reduce the risk of being trapped in a low wage, low productivity but labour-intensive development stage, countries need to strengthen the link between wages and productivity through appropriate wage and labour market policies.

64. Fostering rural development and rural industrialization also requires an inclusive financial system that offers access to financial products and services for the poor, particularly as a significant share of the population, especially the poor and those in the rural sector, remain excluded from accessing financial services. Here, monetary policy can play an important role in fostering more inclusive growth, given its ability to affect the price and volume of credit, and in supporting a framework that encourages the development of a vibrant banking sector that caters to those currently marginalized.

65. Policymakers can also make growth more inclusive by targeting public expenditure to expand equality in opportunities. Indeed, econometric analysis shows that when Governments increase total public expenditure, social inclusiveness, as captured by the index, increases. Such expenditure includes spending on such areas as health, education and social safety nets. It also includes attempts to make existing expenditure more efficient, more effective and more development-oriented. In some countries, such as Sri Lanka, growing inequality is explained mainly by the growing disparity in households' access to education and infrastructure. An important dimension may also be to focus policy on regional economic development — paying special attention to helping the most deserving and vulnerable groups in each region — in order to bridge regional disparities.

66. Governments need to increase the quality of the labour force in order to increase the employability and productivity of workers and to address the issue of inequality of opportunities. One way to do so is to expand investment in education. Another is to increase access to and affordability of health systems. Indeed, public expenditure on health and education has a beneficial impact on social inclusiveness that is more than twice that of total public expenditure. However, no developing Asia-Pacific economy currently allocates 5 per cent of GDP or more as public expenditure on health, as recommended by the Sustainable Development Solutions Network. In many economies, public expenditure does not even reach 1.5 per cent of GDP, including in some of the larger economies of the region, such as Bangladesh, India, Indonesia and Pakistan.

67. One reason for expenditure on health, education and social security being relatively low in many economies in the Asia-Pacific region is that existing expenditure is often not sufficiently development-oriented. For instance, in many economies, significant spending is devoted to defence; in several countries, such expenditure exceeds that on health and education combined. Similarly, significant resources are devoted to subsidies, especially related to energy. While curbing increasing levels of non-development expenditure and removing or reducing harmful subsidies is politically challenging, low oil prices have enabled several countries to move forward in reducing regressive subsidies and boost expenditures on education, health and social protection. These policy measures will further support their efforts at fiscal consolidation and to release additional financial resources for inclusive growth. Reducing non-development expenditure would further free important resources to strengthen social expenditure and to address the large gaps in infrastructure that are impeding development of the region, in particular those of the rural sector.

68. A further limiting factor to making public spending more effective in the region is the fact that tax revenues are quite low in many countries. Using the ESCAP index of inclusiveness, and its subindices, one can see that raising levels of revenue (as a percentage of output) has not had a significant impact on economic inclusiveness in the region, which suggests that tax policy has not been successful in redistributing income there. Yet, higher levels of revenue have increased social inclusiveness, highlighting the importance of revenue for financing development-oriented expenditure to broaden equality in opportunities in the region.